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No. 94-525

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1994

CHARLES C. SMITH, JR., M.D., et al., - Petitioners

versus

COMMONWEALTH OF KENTUCKY
REVENUE CABINET, et al., - - Respondents

On Petition For Writ Of Certiorari
To The Supreme Court Of Kentucky

PETITION FOR A WRIT OF CERTIORARI

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69 pp

QUESTIONS PRESENTED FOR REVIEW

I. Whether the appointment of three special justices to the Supreme Court of Kentucky by the Governor of Kentucky to hear and decide the constitutionality of Kentucky's 2% gross revenue tax on physicians, for which the Governor had strong personal and political interests, violated the Due Process Clause of the Fourteenth Amendment.

II. Whether Kentucky's 2% gross revenue tax on physicians, which is used to fund Kentucky's Medicaid program, violates the Equal Protection Clause of the Fourteenth Amendment since physicians neither caused the social condition being addressed by Medicaid nor are physicians beneficiaries of the Medicaid program.

III. Whether the Opinion of the Supreme Court of Kentucky upholding the classification of physicians for purposes of a 2% gross revenues tax misconstrued the 1991 federal amendment to the Medicaid Act in holding that the amendment compelled the classification when the Amendment by its terms, and as specifically construed by the Health Care Financing Administration, does not sanction any such classification.

PARTIES TO THE PROCEEDINGS IN THE SUPREME COURT OF KENTUCKY

A. *Plaintiffs/Appellees below**

Charles C. Smith, Jr., M.D.
Fred L. Barnett, M.D.
William B. Monnig, M.D.
Kentucky Medical Association
Stuart G. Yoeman, M.D.
Tim Hulsey, M.D.
Joe Davis, M.D.,
President, Warren County Medical Society
Joseph Janes

B. *Defendants/Appellants below*

Commonwealth of Kentucky, Revenue Cabinet

Hon. Kim Burse, not individually but in her capacity as Secretary, Kentucky Revenue Cabinet

Commonwealth of Kentucky, Cabinet for Human Resources

Hon. Masten Childers, II, as successor to Fontaine Banks, Jr., not individually but in his capacity as Secretary, Kentucky Cabinet for Human Resources

Kentucky Health Care Data Commission

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*The Petitioners in this Petition are Charles C. Smith, Jr., M.D.; Fred L. Barnett, M.D.; William B. Monnig, M.D.; and The Kentucky Medical Association. The remaining Plaintiffs/Appellees also challenged The Kentucky Provider Tax, and their case was consolidated with the case at bar (for purposes of briefing and oral argument) in the Kentucky Courts. The Plaintiffs/Appellees also filed a Petition for Writ of Certiorari. The respondents in this Petition are the same as the Defendants/Appellants below.

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PETITION FOR A WRIT OF CERTIORARI TO THE SUPREME COURT OF KENTUCKY

The Petitioners, Charles C. Smith, Jr., M.D., Fred L. Barnett, M.D., William B. Monnig, M.D., and the Kentucky Medical Association, respectfully petition for a writ of certiorari to review the opinion of the Kentucky Supreme Court in this case.

OPINIONS BELOW

The opinion of the Supreme Court of Kentucky is reported at 875 S.W.2d 873 (Ky. 1994) (Appendix A). The opinion of the Franklin County Circuit Court is not reported (Appendix B).

JURISDICTION

The date of the opinion of the Supreme Court of Kentucky is March 24, 1994 (Appendix A). The date of denial of a timely petition for rehearing was June 23, 1994 (Appendix C). The statutory provision which confers jurisdiction on this Court is 28 U.S.C. § 1257(a).

STATUTORY AND CONSTITUTIONAL PROVISIONS INVOLVED

The pertinent part of House Bill No. 1 from the 1993 Second Extraordinary Session of the General Assembly of the Commonwealth of Kentucky, codified in section 142.207(1) of the Kentucky Revised Statutes (1993), provides:

> A tax is hereby imposed on the gross revenues received on or after July 1, 1993, for the provision of . . . physicians services . . . at a rate of two percent (2%) of the gross revenues received . . . for the provision of health care items or services . . . .

The pertinent parts of the Medicaid Voluntary Contribution and Provider Specific Tax Amendments of 1991, Pub. L. No. 102-234, 105 Stat. 1793, codified as amended at 42 U.S.C. §§ 1396a and 1396b (1994), provides:

> Notwithstanding the previous provisions of this section, for purposes of determining the amount to be paid to a State . . . for quarters in any fiscal year, the total amount expended during such fiscal year as medical assistance under the State plan . . . shall be reduced by the sum of any revenues received by the State . . . during the fiscal year —
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> * * *
>
> from health care related taxes . . . other than broad-based health care related taxes . . .
>
> from a broad-based health care related tax, if there is in effect a hold harmless provision . . . .
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> * * *
>
> In this subsection, the term "broad-based health care related tax" means a health care related tax which is imposed with respect to a class of health care items or services . . . and which . . .
>
> is imposed at least with respect to all items or services in the class . . . and is imposed uniformly . . . .

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides: "No state shall make or enforce any law which shall . . . deprive any person of life, liberty, or property, without due process of law . . . ."

The Equal Protection Clause of the Fourteenth Amendment to the United States Constitution provides: "No state shall make or enforce any law which shall . . . deny to any person within its jurisdiction the equal protection of the laws."

STATEMENT OF THE CASE

The Petitioners in this case are comprised of four (4) physicians and the Kentucky Medical Association, Inc. ("KMA"). The physicians are licensed to practice medicine in the Commonwealth of Kentucky where they perform medical services for fees. All but one of the physicians participate in the state Medicaid system. The remaining physician does not participate in the state Medicaid system, but does accept indigent patients as a regular part of his practice. Under the Medicaid system, state and federal funds are used to help provide medical care for indigent Kentuckians. For every dollar of state expenditures, Kentucky Medicaid receives federal matching funds (called Federal Financial Participation, or FFP) under 42 U.S.C. § 1396 *et seq.* in the amount of approximately $2.50.

The KMA is a non-profit Kentucky corporation representing approximately 4,000 physicians practicing medicine in Kentucky, many of whom accept Medicaid patients as a regular component of their medical practice, some of whom do not. Included among KMA's corporate objectives is statewide education about medicine and the enactment and enforcement of just medical laws.

In 1990, the Kentucky General Assembly enacted a tax on physicians' Medicaid receipts for the purposes of receiv-

ing corresponding federal matching Medicaid funds. *See* KRS 205.575. Once the federal funds were obtained, Kentucky's law required the physician tax to be returned to the physicians. This had the effect of increasing the level of federal matching funds without the state actually expending corresponding state funds.[1] In response, on December 12, 1991, the United States Congress enacted the Medicaid Voluntary Contribution and Provider Specific Tax Amendments of 1991, Pub. L. 102-234, 105 Stat. 1793 (codified as amended at 42 U.S.C. 1396a & 1396b (1994)) (hereinafter the "1991 Amendment"). The 1991 Amendment potentially restricted the amount of federal contributions state Medicaid programs would receive *to the extent such programs were funded by health care related taxes.* Under the 1991 Amendment, the amount of state expenditures the federal government would recognize for purposes of determining the corresponding level of federal contributions would be reduced by the amount of any "impermissible" health care related tax. A tax was declared to be "health care related" if it met any of the following four criteria: (1) The tax was imposed on the provision of, or the authority to provide, health care services; (2) The tax was imposed on the payment for health care services; (3) The tax was "related" to health care items or services[2]; or (4) The tax discriminated against health care items or ser-

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[1]Kentucky was but one of a number of states to employ this scheme.

[2] A tax is "related" to health care items or services if at least 85 percent of the burden of such tax falls on health care providers. For example, a tax which is imposed at equal rates on gross revenues of physicians and attorneys is a health care-related tax if 85 percent or more of the total tax burden falls on physicians.

vices.[3] 105 Stat. 1793 (1991). *A state tax which did not meet any of the above criteria was not a health care related tax; accordingly, no reduction in federal contributions would occur as a result of the state's receipt of the associated tax revenues.*

If determined to be "health care" related, a state tax was required to meet three additional standards in order to avoid a reduction in federal contributions: (1) The tax must be broad-based — i.e., applied to all health care items and services within a class of health care items and services specified in the Act, (2) The tax must be uniformly imposed — i.e., applied using an equal rate or amount to each health care item or service within the class of health care items or services taxed, and (3) The tax cannot hold taxpayers harmless for their tax costs. Any health care related tax which failed to meet any of the three criteria was an impermissible tax, the revenues from which would be subtracted from the state's Medicaid expenditures qualified to receive corresponding federal contributions. *Id.*

The 1990 Kentucky tax on physicians' Medicaid receipts, and corresponding refund, violated all three of the criteria found in the 1991 Amendment — and thus, unless amended, Kentucky's Medicaid expenditures qualifying for federal matching funds would be reduced by the amount of the state tax revenue.

Solely in response to the 1991 Amendment, on May 27, 1993 the Second Extraordinary Session of the 1993 Kentucky General Assembly enacted House Bill 1, the so-called

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[3]A tax is discriminatory if, although not limited to health care providers, the tax treatment of health care providers is different from the tax treatment of other entities subject to the tax. For example, if a tax is imposed on physicians and attorneys, but the tax rate imposed on physicians is greater, the tax on physician services is considered to be a separate health care related tax.

"provider" tax. *See* KRS 142.201-259.[4] House Bill 1 imposed taxes on three separate segments of the health care industry: (1) hospitals, (2) health care providers other than hospitals[5], and (3) pharmacies and others dispensing prescription drugs.

Section 2 of House Bill 1 imposed a tax on "all hospitals providing health care items or services or hospital services at a rate of two and one-half percent (2.5%) of the gross revenues received on or after July 1, 1993, for the provision of health care items or services or hospital services." *See* KRS 142.203. Section 1(5) of House Bill 1 defined "hospital services" as all inpatient and outpatient services provided by a hospital, excluding the dispensing of prescription drugs on an outpatient basis by separately licensed hospital pharmacies. *See* KRS 142.201(5).

Section 3 of House Bill 1 imposed a two percent (2%) tax on the gross revenues of health care providers (other than hospitals) for the provision of physicians services, home health care services, health maintenance organization services, and the provision of any other specific health care items or services that federal legislation or regulation permits the state to tax. *See* KRS 142.207. *The tax was imposed on total gross receipts of every Kentucky physician, regardless of whether the physician had elected to participate in the State Medicaid program.*

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[4]House Bill 1 expired by its own terms on July 15, 1994. However, the 1994 Regular Session of the Kentucky General Assembly enacted House Bill 250 which contains a "provider" tax fundamentally identical to the tax in House Bill 1.

[5]KRS 142.201(9) defined "provider" as any individual or entity providing health care items or services or hospital services against which the state is permitted to impose a provider tax pursuant to federal legislation or regulation, excluding facilities operated by the federal government, and excluding any class of provider that includes provider groups that are prohibited by state law from participating in the state medicaid program.

Section 4 of House Bill 1 imposed a tax on pharmacies and all other providers (including physicians) dispensing outpatient prescription drugs at a rate of $0.25 per prescription upon outpatient prescription drugs for which delivery was taken in Kentucky on or after July 1, 1993. Section 4(1)(a) permitted pharmacies to pass the tax on to insurers or other health organizations with whom the pharmacies had entered into contracts for the provision of health care items or services. *See* KRS 142.211. Section 5(1) of House Bill 1 prohibited other providers, including the petitioning physicians, from similarly passing on their tax. *See* KRS 142.213(1).

The petitioners filed the herein action claiming that the Kentucky provider tax set forth in House Bill 1 was arbitrary and irrational, and constituted a violation of their federal and state guaranteed constitutional rights to Due Process (U.S. Const., Amend. XIV; Ky. Const. § 2) and Equal Protection (U.S. Const., Amend. XIV; Ky. Const. § 3). The petitioners also relied upon Kentucky Constitution § 59 — a Kentucky constitutional provision which prohibits "special" tax legislation.[6] The trial court did not reach the due process and equal protection arguments; instead, the court held House Bill 1 to be violative of Kentucky Constitution § 59. (*See* Appendix B). The Respondents appealed to the Kentucky Court of Appeals, and then sought a transfer of the case to the Kentucky Supreme Court. The transfer was granted.

After transfer, three justices of the Kentucky Supreme Court recused themselves from hearing the case. This recusal triggered Kentucky Constitution § 110(3), which

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[6]As held by the Kentucky Supreme Court in this case, the constitutional test for "special" legislation is very similar to the tests for due process and equal protection. *See Commonwealth v. Smith*, 875 S.W.2d 873, 876 (Ky. 1994).

authorized the Governor of Kentucky, Honorable Brereton C. Jones, to appoint three "special" justices to hear the appeal. This same Governor had called the 1993 special session of the Kentucky General Assembly — the session which produced House Bill 1 as its only piece of legislation. Governor Jones publicly took extreme pride in the passage of House Bill 1. Also, two of the Governor's executive agencies (the Kentucky Revenue Cabinet and the Cabinet for Human Resources) were appellants in the case. Moreover, Governor Jones authorized the hiring and selection of the state's outside counsel. However, instead of deferring his appointments to some disinterested authority (say, the Kentucky Chief Justice or the Kentucky Bar Association), the Governor personally named three practicing attorneys to sit on the appeal.[7]

This ad hoc tribunal overruled the petitioners' Motion to Recuse, and ultimately reversed the lower court on March 24, 1994. The decision was 5-2, with all three Gubernatorial appointees voting with the majority. The opinion held that House Bill 1 did not violate Kentucky Constitution § 59, nor were state or federal due process or equal protection guarantees offended. (*See* Appendix A). The rationale for the Court's opinion was basically three-fold: (1) The petitioners herein failed to affirmatively negate every conceivable rationale for the statute; (2) The 1991 Amendment to the federal legislation authorized and called for the Kentucky provider tax to be imposed on physicians — thus creating the rationality necessary to support due process and equal protection; and (3) Since physicians ostensibly benefit from Medicaid, it was fair and rational to impose a tax only upon them (as opposed to other segments of the public as a whole).

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[7]The Governor actually appointed four attorneys, but one chose to recuse himself after it was disclosed that his company had been employed by the state of Kentucky under a multi-million dollar health insurance contract.

The Petitioners filed a Petition for Rehearing on April 13, 1994, which was denied by the Kentucky Supreme Court (as empaneled by Governor Jones) on June 23, 1994. (*See* Appendix C).

REASONS FOR GRANTING THE PETITION

Without question, one of the most significant social and political issues in America today is health care reform. Inseparable from this serious concern is the interaction between the various federal and state social welfare programs, including the Medicaid program. Kentucky, through the political aspirations of its Governor, has sought to be one of the leaders in providing universal health care coverage for its citizens. Fundamental to this goal was the passage of House Bill 1 and its 2% gross revenue tax on physicians — a politically expedient group.

Kentucky's passage of House Bill 1 and the resulting litigation have been closely watched by many states, and will no doubt serve as the impetus for similar legislation and litigation in those states. Unless this petition is granted, this case will be but the first in a series of expensive and complex litigation certain to emanate as this nation struggles to fund health care programs such as Medicaid. The need for guidance from this Court at the outset of such a consequential issue is acute. This case presents a timely opportunity for this Court to establish the constitutional limits the states are constrained to observe in imposing taxes to fund health care legislation, as well as the proper interpretation of federal health care law.

Review of this case is especially compelling in light of the unique makeup of the Kentucky Supreme Court which upheld the physicians' tax against state and federal constitutional challenges. Specifically, the legislation at issue was drafted, sponsored and supported by the Governor of Kentucky — the same Governor who under the Kentucky Constitution appointed three special justices to the Kentucky Supreme Court to determine the constitutionality of

the tax. Not only do these appointments violate federal due process principles, the appointments should cause this Court to be suspect of the Kentucky Supreme Court's independence in upholding the tax by a 5-2 vote, wherein the three (3) gubernatorial appointees voted in the majority.

I. Kentucky's Provider Tax Was Upheld by an Unconstitutionally Empaneled Tribunal.

A "fair trial in a fair tribunal is a basic requirement of due process." *In re Murchison*, 349 U.S. 133, 136 (1955). Due process extends even to the more subtle indicia which create the appearance of or potential for impropriety. Stated simply, due process requires that litigants be granted a fair trial before an impartial decision maker that is constitutionally empaneled.

> Fairness of course requires an absence of actual bias in the trial of cases. But our system of law has always endeavored to prevent even the probability of unfairness. To this end no man can be a judge in his own case and no man is permitted to try cases where he has an interest in the outcome. *That interest cannot be defined with precision. Circumstances and relationships must be considered.*

In re Murchison, 349 U.S. at 136 (emphasis added). Similarly, this Court has recognized that "[e]very procedure which would offer a possible temptation to the average man as a judge . . . not to hold the balance nice, clear and true between the state and the accused denies the latter of due process of law." *Tumey* v. *Ohio*, 273 U.S. 510, 532 (1927); *see also In re Murchison*, 349 U.S. at 136 (quoting *Tumey*, 273 U.S. at 510).

The rule is a demanding one. This Court has recognized that the rule's application may disqualify judges who, in fact, are truly impartial. In order to maintain the institutional integrity of American courts, *and to ensure every litigant's due process right to a fair tribunal*, this Court has recognized the necessity of a rule with such absolute dimension. Specifically, this Court has held:

> The due process clause "may sometimes bar trial by judges who have no actual bias and who would do their very best to weigh the scales of justice equally between contending parties. But to perform its high function in the best way 'justice must satisfy the appearance of justice.'"

In re Murchison, 349 U.S. at 136 (citation omitted); *see also Aetna Life Ins. Co.* v. *Lavoie*, 475 U.S. 813, 825 (1986).

Due process requires (1) that the special justices who presided over this appeal be unbiased in fact, (2) that they have an appearance of being unbiased, and (3) that the method of their appointment be reasonably calculated to safeguard against the potential for impropriety and undue influence.

These requirements of due process were not satisfied in this case. The Governor of Kentucky, the Commonwealth's Chief Executive, employed a procedure which unconstitutionally altered the composition of the Court presiding over this appeal. The procedure, as designed and as applied in this case, contravened the Constitution of the United States. Specifically, the participation and votes of the three special justices in the March 24, 1994 Opinion of the Kentucky Supreme Court were void and violative of the due process rights of the petitioners. The Kentucky Supreme Court failed to recognize this unlawful encroachment of the petitioners' constitutional rights when the Court twice denied the Petitioners' Motion to Recuse, and again when the Court denied the petition for rehearing.[8]

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[8]Instead, the Court should have affirmed the opinion of the Franklin Circuit Court pursuant to the 2-2 vote of the properly seated members of the Kentucky Supreme Court as required by KRS 21A.060 and Rule 1.020(l)(a) of the Rules of the Kentucky Supreme Court. (This statute and the complementary Supreme Court rule provide that a tie vote in the Supreme Court affirms the opinion of the lower court. The rules by which this Court operates contain a similar provision. *See* 28 U.S.C. § 2109.)

These actions violate the petitioners' right to due process for at least three reasons.

First, the Governor who appointed the special justices had a personal interest in the outcome of this case. Second, each of the three special justices was a practicing attorney during his tenure on the Supreme Court. Finally, the procedure by which the special justices were appointed created constitutionally impermissible opportunities for impropriety and undue influence.

A. THE GOVERNOR'S PERSONAL AND POLITICAL INTEREST IN THE OUTCOME OF THIS CASE RENDERS VOID HIS APPOINTMENT OF SPECIAL JUSTICES.

Perhaps the most fundamental restriction on the Governor's appointing power rests in public policy. A public officer entrusted with the power of appointment, including the power to appoint special justices, should exercise that power solely for the benefit of the public. The law must secure the utmost freedom from personal interest in the making of appointments; otherwise, the appointments are void. *See, e.g., Wood* v. *Town of Whitehall*, 120 Misc. 124, 197 N.Y.S. 789 (Sup. Ct. 1923); *Hornung* v. *State*, 116 Ind. 458, 19 N.E. 151 (1888); 63A Am. Jur. 2d *Courts* § 100, at 743 (1984).

The purposes behind this policy are numerous and need little explanation. Ensuring the actual and perceived integrity of its judiciary, both regularly seated and specially appointed, is a paramount responsibility of the state. In appointing special justices, the Governor places them in offices of public trust. Any such office, particularly a judicial one, must remain distant and distinct from partisan politics in order to maintain the independence, impartiality and freedom which the public has a right to expect from their judiciary.

In the 1993 Special Session, Kentucky's Governor unequivocally manifested his bias in favor of the legislation. Indeed, Governor Jones has made health care reform for Kentucky the centerpiece of his administration. Thus, not only was the Governor personally involved in the legislation as the head of the executive branch of government, he also had a heightened personal interest in the outcome of this provider tax case.[9]

By making these three special justice appointments, the Governor created a situation in which the average citizen could reasonably believe that the makeup of the Kentucky Supreme Court was being manipulated to produce a certain result, and thus, to promote an individual's political aspirations. This violates every ideal of justice and fairness, including the Due Process Clause of the Fourteenth Amendment to the United States Constitution. In upholding the constitutionality of these appointments, the Kentucky Supreme Court assured that the denial of Petitioners' due process rights would be complete.

B. THE APPOINTMENT OF PRACTICING LAWYERS AS SPECIAL JUSTICES VIOLATES DUE PROCESS.

The selection of justices to the Kentucky Supreme Court is entrusted to the electorate. Ky. Const. § 117. Only in the most unusual case where two or more justices decline or are unable to sit can a vacancy be filled by appointment.[10] Subsection (3) of Section 110 of the Kentucky Constitution provides:

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[9]The extent of the Governor's involvement is amply demonstrated in the Petition for Writ of Certiorari filed by Petitioners Stuart G. Yeoman, M.D., Tim Hulsey, M.D., Joe Davis, M.D., and Joseph Janes.

[10]The system created by the Kentucky Constitution is similar to the system which allows this Court to proceed without recused justices so long as a quorum exists. *See* 28 U.S.C. §§ 1, 455 and 2109.

> A majority of the Justices of the Supreme Court shall constitute a quorum for the transaction of business. If as many as two Justices decline or are unable to sit in the trial of any cause, the Chief Justice shall certify that fact to the governor, who shall appoint to try the particular cause a sufficient number of Justices to constitute a full court for the trial of the cause.

Thus, if two or more justices recuse themselves, only the Governor is given the power to appoint special justices to the Kentucky Supreme Court and, pursuant to the requirements of due process, this power is carefully circumscribed. The Governor cannot appoint a single justice and must appoint a sufficient number to constitute a full court. Most important for purposes of this case, special justices must possess the same qualifications as regularly elected Supreme Court Justices. *See* Ky. Const. §§ 122, 123; KRS 21A.120(1). The most relevant qualification is embodied in Section 123 of the Kentucky Constitution, which provides that:

> During his term of office, no justice of the Supreme Court or judge of the Court of Appeals, Circuit Court or District Court shall engage in the practice of law, or run for elective office other than judicial office, or hold any office in a political party or organization.

This provision is reinforced by Section 110(5) of the Kentucky Constitution which permits only active or retired judges or justices to be appointed to a judicial body.

If the Kentucky constitutional directives in Section 110 and Section 123 are disregarded, the due process rights of persons subject to the tribunal are violated. When this occurs, the applicable law is clear. Since the office is held unlawfully, the appointed justice lacks jurisdiction to act, rendering void any actions taken by him. This Court has succinctly articulated this legal truism: "If the statute made him incompetent to sit at the hearing, the decree in which he took part was unlawful, and perhaps absolutely

void and should certainly be set aside or quashed by any court having authority to review it by appeal, error or certiorari." *American Construction Co.* v. *Jacksonville, Tampa & Key West Ry. Co.*, 148 U.S. 372, 387 (1893) (citations omitted).

Various other jurisdictions, including Kentucky, have adopted this principle. *See, e.g., Thompson* v. *Commonwealth*, 266 Ky. 529, 99 S.W.2d 705 (1936); *Feck* v. *Commonwealth*, 264 Ky. 556, 95 S.W.2d 25 (1936); *see also National Bank of Washington* v. *McCrillis*, 130 P.2d 901 (Wash. 1942). Moreover, in *Clements* v. *Ft. Worth & D.S.P. Ry. Co.*, 7 S.W.2d 895, 898 (Tex. App. 1928), the court held:

> [A] judgment rendered by a special judge who had not been appointed or selected in accordance with the constitutional and statutory requirements governing such matters is an absolute nullity, and that before a special judge can be appointed or selected, the conditions pointed out by the Constitution and the statute must exist before such selection or appointment of the special judge is valid.

Under the foregoing rule, the participation of the three special justices in this case was void. Not surprisingly, the special justices cast the deciding votes and obviously controlled the ultimate decision. The justices properly seated in this appeal were equally divided 2-2: two voting to affirm the Franklin Circuit Court's opinion and two voting to reverse. Clearly, Section 123 made the special justices incompetent to sit in review of this case and rendered their appointments unlawful and their participation and votes void *ab initio*. Therefore, to satisfy the petitioners' right to due process, the judgment of the Franklin Circuit Court must be reinstated pursuant to the tie vote of the constitutionally empaneled justices. *See United States* v. *Emholt*, 105 U.S. 414 (1882); *Nelson* v. *Carland*, 42 U.S. (1 How.) 265 (1843). This result is compelled not only because the

parties are entitled to it, but because public policy surrounding the fair administration of the judicial process demands it.

C. THE APPOINTMENT OF PRACTICING LAWYERS AS SPECIAL JUSTICES CREATED CONSTITUTIONALLY IMPERMISSIBLE OPPORTUNITIES FOR IMPROPRIETY AND UNDUE INFLUENCE IN VIOLATION OF THE REQUIREMENTS OF DUE PROCESS.

The shroud of impropriety created by the appointment of practicing lawyers as special justices deprived the petitioners of their constitutionally protected right to due process. When an attorney from the active bar is selected to sit as a special justice, there is the likelihood that the appointee has or will later have a case before the Supreme Court for which he or she has been specially chosen. Such an appointee may find it difficult to take a position contrary to the opinion of the majority and/or the chief justice so as not to alienate those justices in his or her litigation. This presents an obvious and unacceptable conflict of interest: The role of advocate is wholly incompatible with the role of jurist. *See Aetna Life Ins. Co.* v. *Lavoie*, 475 U.S. 813 (1986).

This conclusion, arising from the requirements of due process, is further supported by Kentucky Constitution Section 110(5)(b). This provision directs the Kentucky Chief Justice, in appointing special judges for the lower courts in Kentucky, to select only active or retired justices or judges, and not practicing attorneys. The reason, no doubt, is to keep practicing attorneys from deciding cases where they, or their clients, might exert bias or influence into the process. It would be both paradoxical and illogical, for the Kentucky Constitution to allow the Governor to inject onto the Kentucky Supreme Court the precise risk of bias prohibited by Section 110(5)(b) from being placed onto courts of lesser prominence.

The due process right to an impartial tribunal demands that *any* process of appointing special justices be reasonably calculated to prevent impermissible impropriety and undue influence. Kentucky's system, *as applied in this case*, has failed to provide the requisite assurances of due process. Accordingly, the due process guarantee of the United States Constitution demands that this procedure be stricken.

II. Kentucky's Provider Tax Creates an Arbitrary and Discriminatory Classification in Violation of the Equal Protection Clause of the United States Constitution.

While this Court has traditionally accorded deference to state taxation classifications, any such classification must nevertheless satisfy the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. *Allegheny Pittsburgh Coal Co.* v. *County Com. of Webster County*, 488 U.S. 336 (1989). Kentucky's provider tax as found in House Bill 1 (and as reenacted in 1994 in House Bill 250) unreasonably singles out certain health care providers for a tax levied to fund Kentucky's Medicaid program. Because the program funded by the tax inures to the benefit of the Kentucky citizenry as a whole, *and confers no special benefit upon the providers forced to fund that program*, the imposition of the provider tax constitutes a denial of equal protection of the laws in contravention of the Fourteenth Amendment to the United States Constitution.

As this Court noted in *F. S. Royster Guano Co.* v. *Virginia*, 253 U.S. 412, 415 (1900), to be constitutional a classification "must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike."

On its face, the classification found in Kentucky's provider tax is arbitrary and is not based upon any sound distinction between physicians and the population generally. The "object of the legislation" is the raising of revenues to fund Kentucky's Medicaid program. This social program inures to the benefit of the population as a whole in that it ensures at least a minimal level of health care to the indigent. Physicians gain no special benefit from Medicaid; in fact, physicians already support the Medicaid program to a greater degree than the general populace through reduced fees and other accommodations. To the extent physicians are compensated through Medicaid, that compensation is merely *quid pro quo* for medical services rendered.[11] Indeed, House Bill 1 is actually perverse — for it financially penalizes those who render the precise Medicaid services desired by the state. Thus, the tax discourages the rendering of the service — it does not promote it.

Because the benefit derived from the provider tax inures to the benefit of all society generally, House Bill 1 unjustly and unconstitutionally saddled a discreet minority — physicians — with a disproportionate share of the expense of this benefit. As the Court has recently noted: "The Equal Protection Clause . . . keeps governmental decision-makers from treating differently persons who are in all relevant respects alike." *Nordlinger* v. *Hahn*, ___ U.S. ___, 112 S.Ct. 2326, 120 L.Ed. 2d 1, 12 (1992). For purposes of a tax to fund Medicaid, the physicians of Kentucky and the citizenry as a whole "are in all relevant

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[11]In *Butler* v. *United Cerebral Palsy of Northern Kentucky, Inc.*, 352 S.W.2d 203, 205 (Ky. 1961), the Kentucky court held that the private institutions providing care for handicapped children were not beneficiaries of state aid being paid to the institutions; rather, the beneficiaries were the persons receiving the care.

respects alike," rendering the tax imposed solely against physicians violative of equal protection.

This Court has recently declined the opportunity to determine whether a "status tax" such as that imposed against physicians by Kentucky's provider tax can withstand scrutiny under the Fourteenth Amendment to the United States Constitution. *Coy* v. *Florida Birth-Related Neurological Injury Compensation Plan*, 595 So.2d 943 (Fla. 1992), *cert. denied, McGibony* v. *Florida Birth-Related Neurological Injury Compensation Plan*, ___ U.S. ___, 113 S.Ct. 194, 121 L.Ed. 2d 137 (1992). In denying *certiorari*, this Court let stand a tax imposed by the State of Florida against all doctors to create a fund to compensate victims of birth-related neurological injuries. The tax was challenged on the ground that it benefited only obstetricians and the public generally, yet was imposed against physicians as a class, including those who had no involvement with the delivery of babies.

Kentucky's tax pushes the "status tax" question to a higher level than that reached in *Coy*. In *Coy*, it was undisputed that at least some physicians benefited from the program funded by the tax to a greater extent than members of the public generally. Moreover, the program at issue in *Coy* involved a medical condition, thus raising various potential bases on which to relate the program to physicians. Conversely, the societal ill addresses by Medicaid is wholly economic, rather than medical, and the physicians of Kentucky have not caused or contributed to the indigence that makes Medicaid necessary and desirable. Physicians receive no greater benefit from Kentucky's ability to fund health care for the indigent than do other citizens of Kentucky, as was tacitly acknowledged by the Kentucky Supreme Court. *Commonwealth* v. *Smith*, 875 S.W.2d 873, 876 (Ky. 1994) ("The populace, as a whole, derives benefits from a healthy citizenry.") The present

case thus places the constitutionality of a so-called "status tax" more squarely before this Court than did *Coy*.[12]

Review of this case would also allow the Court to explain and to apply the principles of *Davis* v. *Michigan*, 489 U.S. 803 (1989), to a case which does not necessarily involve the doctrine of intergovernmental immunity (as did *Davis*), but does involve substantial federal interests being discriminated against by a state tax. In *Davis*, this Court struck down a Michigan tax scheme which exempted state pensions from tax, but not federal pensions. After concluding that facial discrimination existed against federal retirees, the Court rejected the rationales sponsored by the state to justify the distinctions. The Court in *Davis* noted: "In determining whether this standard of justification has been met, it is inappropriate to rely solely on the mode of analysis developed in our equal protection cases . . . because 'the Government's interests must be weighed in the balance.'" 489 U.S. at 816 (quoting *Phillips Chemical Co.* v. *Dumas Independent School Dist.*, 361 U.S. 376, 385 (1960)). In the case at bar, the Court will be called upon to determine whether the federal government's interest must be weighed in an equal protection analysis.

The provider tax imposed by Kentucky in House Bill 1 had its genesis in the federal Medicaid statutes prior to 1990. Medicaid was and is a federal program to be administrated by the states; certainly the approximately 2.5 to 1 federal match demonstrates the degree of federal interest in seeing that indigent Americans receive health care. In 1990, solely as a mechanism to extract greater federal funds,

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[12]By analogy, if House Bill 1 were constitutional, a state could tax grocery stores on *all* of their gross receipts to fund the Food Stamp program; could tax lawyers on all of their fees to fund the judicial system; and could tax policemen to fund the prison system.

Kentucky passed KRS 205.575, a phantom tax on doctors which could then be used to obtain federal matching funds.[13] Consequently, only because of this federal Medicaid program did physicians find themselves being taxed in 1990; and only because the 1991 Amendment undertook to apply some criteria to these schemes did the classification of Kentucky physicians continue. Indeed, in its present form, the tax imposed by House Bill 1 remains a tax used solely to obtain more federal Medicaid funds from those persons eligible to participate as physicians in the federal Medicaid program. Since Medicaid reimbursement is less than standard physician charges, the tax imposed by House Bill 1 in effect provides a disincentive for physicians participating in Medicaid, and thereby frustrates the federal Medicaid program as a whole. For such a serious result, Kentucky seemingly would have to have a strong rationale to support the classification of physicians. No such rationale exists. Accordingly, this case presents the Court with the opportunity to explain the impact of *Davis* v. *Michigan* on attempts by states to interfere with federally mandated programs via unlawful tax classifications.

There is no legitimate or rational basis for imposing upon physicians a special tax to help fund Kentucky's Medicaid program. In reality, of course, physicians (and other health care providers) have been singled out for the simple reason that they are a politically expedient target. It is precisely this sort of selective taxation that the Equal Protection Clause of the Fourteenth Amendment prohibits. The potentially far-reaching implications of permitting the imposition of taxes based merely on status warrant resolu-

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[13]As an aside, the KMA opposed the passage of KRS 205.575.

tion of this important constitutional question by this Court.[14]

The Kentucky Supreme Court ruled against the petitioners' argument by noting that physicians receive benefits from Medicaid. *Commonwealth* v. *Smith*, 875 S.W.2d at 876. As noted, however, physicians' "benefits" are no more than payment for services rendered. Furthermore, other entities receive monies from Medicaid, yet they were not taxed by House Bill 1. For example, Kentucky taxicabs and other transportation companies receive millions of dollars annually for services provided to Medicaid. Also, nurse midwives, nurse practitioners and dental services were not taxed[15] although each of these providers participated in Medicaid. These circumstances compel the conclusion that Kentucky's taxing scheme created by House Bill 1 unconstitutionally singled out physicians as a class to fund Medicaid. Allowed to go unchecked by this Court, Kentucky's discriminatory tax treatment of health care providers will no doubt encourage similar taxes in other states.

III. The Kentucky Supreme Court Misconstrued Federal Law in Upholding Kentucky's Discriminatory Provider Tax.

The Kentucky Supreme Court first ruled that Kentucky's discriminatory provider tax was rationally based on federal law. *Commonwealth* v. *Smith*, 875 S.W.2d 873, 876 (Ky. 1994) ("Simply put, the Kentucky statute was designed to meet the federal statute which provides and enumerates the specific requirements as to the class of

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[14]Already, provider taxes similar to Kentucky's have been passed in West Virginia (W. Va. Code § 11-27-16 (1994)) and Minnesota (Minn. Stat. § 295.52 (1993)).

[15]Peculiarly, the tax was expanded to include dental services after passage of House Bill 1 because of a change in federal law, not state law.

health care providers that may be taxed in order to qualify for matching funds."). The Court then concluded that, because of this federal basis, the tax withstands scrutiny under the Constitution of Kentucky. *Id.* ("Thus, when a state elects to enact a provider tax, its discretion in classifying those who will be taxed appears circumscribed by federal law. Thus, defining the class in a coextensive manner with the federal law results in a rational basis for such classification without arbitrariness."). However, in making these rulings, the Kentucky Supreme Court misconstrued the relevant federal law and thereby determined the constitutional questions under a misinterpretation of federal law. This erroneous construction of federal law renders the opinion upholding the tax invalid.

While the Kentucky Supreme Court is the final arbiter of questions arising under the Constitution of Kentucky, where, as here, that court bases its determination of a state constitutional question on an erroneous interpretation of *federal* law, this Court has jurisdiction pursuant to 28 U.S.C. §1257(a). *See Three Affiliated Tribes of Ft. Berthold Reservation* v. *Wold Engineering*, 467 U.S. 138, 152 (1984) ("If the state court has proceeded on an incorrect perception of federal law, it has been this Court's practice to vacate the judgment of the state court and remand the case so that the court may reconsider the state-law question free of misapprehensions about the scope of federal law."). Moreover, because the Kentucky Supreme Court's misapplication of federal law also resulted in its upholding the tax against federal constitutional challenge, this Court should review the decision rather than merely remand. *See Commonwealth* v. *Smith*, 875 S.W.2d at 878 ("Sections 1, 2 and 3 of the Kentucky Constitution embrace the equal protection clause to the Fourteenth Amendment to the United States Constitution.").

The Kentucky Supreme Court relied upon the 1991 Medicaid Amendment in upholding Kentucky's provider tax. Under this Amendment, the level of state expenditures used to determine the level of federal matching funds must be reduced by impermissible "health care related taxes." When a state tax is "related to" health care services, to qualify for matching funds the Amendment requires the tax: (1) to be broad-based; (2) to be uniformly imposed; and (3) to not hold taxpayers harmless for their tax costs. Health care-related taxes which fail to meet the three criteria are impermissible, the revenues from which will be subtracted from the state's medical assistance expenditures qualified to receive matching federal funds. *Significantly, non-health care related taxes are not subject to these three criteria, and are entitled to receive the full level of corresponding federal matching funds.*

In light of the foregoing Amendment, Kentucky's 1990 tax scheme was not entitled to receive federal matching funds. Kentucky therefore passed House Bill 1, a provider tax which meets the requirements of federal law to receive matching funds. However, the Kentucky Supreme Court, in upholding House Bill 1, went much further than the federal statute permits — *i.e.*, the Kentucky Court held that the 1991 Amendment compelled the state to pass a provider tax, and that such federal compulsion served as the basis for "rationality" under the Equal Protection Clause. This reasoning is flawed — instead of the premises being used to support the conclusion, just the opposite has occurred. Indeed, the 1991 Amendment's requirements are triggered only *after* a state makes the initial determination to tax one or more of the enumerated classes of health care items or services. The 1991 Amendment leaves to the states the determination of whether to tax a particular class in the first instance, and whether the classification passes constitutional state muster.

The distinction between what the 1991 Amendment actually provides and what the Supreme Court of Kentucky interpreted it as providing is unmistakable. The 1991 Amendment requires only that any state health care-related tax meet the three requirements in order to receive the federal match. The Amendment says nothing about the legality of the imposition of the tax in the first instance. This could not be clearer. In *Medicaid Program; Limitations on Provider-Related Donations and Healthcare-Related Taxes; Limitations on Payments to Disproportionate Share Hospitals*, 58 Fed. Reg. No. 155, at 43,157 (1993), the Department of Health and Human Services, Health Care Financing Administration declared: "Nothing in [the 1991 Amendment] was intended to encourage or sanction taxes on health care providers. Rather, the provisions of the law and implementing regulations merely stipulate the rules governing the availability of FFP [federal financial participation] when States impose such taxes."

The Kentucky Supreme Court erroneously determined that the 1991 Amendment "mandate[d]" that the legislature tax only the enumerated health care items or services. *Commonwealth* v. *Smith*, 875 S.W.2d at 876. However, the 1991 Amendment cannot be relied upon as a basis to support the constitutionality (state or federal) of such classifications. In fact, because the 1991 Amendment is best viewed as operating to discourage health care related taxes, it is fundamentally irrational to interpret the same Amendment as placing a federal imprimatur on such discriminatory taxes.

The gravity of the error committed by the Kentucky Supreme Court is substantial. In effect, the Kentucky Supreme Court has tested the state and federal constitutionality of Kentucky's provider tax on a clearly erroneous interpretation of federal statutory law. The crucial interplay between the federal government and the states in the administration of the Medicaid program demands this Court's intervention.

CONCLUSION

For the foregoing reasons, this petition for writ of certiorari filed by Charles C. Smith, Jr., M.D., Fred L. Barnett, M.D., William B. Monnig, M.D., and the Kentucky Medical Association, should be granted.

Respectfully submitted,

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